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# Peerless Insurance Co. v. Freeman: Adding to the Confusion Involved in Terminating an Insurance Policy According to North Carolina's Financial Responsibility Legislation

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## *Peerless Insurance Co. v. Freeman*: Adding to the Confusion Involved in Terminating an Insurance Policy According to North Carolina's Financial Responsibility Legislation

The Vehicle Financial Responsibility Act of 1957[1] imposes a requirement of proof of liability insurance protection on all owners of state-registered motor vehicles. Because evidence of continuous policy coverage is essential to provide such proof,[2] the statute includes extensive restrictions affecting the termination of an otherwise ordinary contractual relationship.[3] North Carolina precedent interpreting the restrictive provision reflects confusion among members of both the insurance business and the legal profession regarding the distinction between acts of termination attributed to the insured, which require no notice from the insurer, and those attributed to the insurer, which necessitate the prescribed notice.[4] Although it effectively addressed the question of timeliness of notice of cancellation under North Carolina's version of financial responsibility legislation, the North Carolina Court of Appeals in *Peerless Insurance Co. v. Freeman*[5] raised troublesome issues of public policy and legislative intent regarding uncompensated extended insurance coverage. Despite the apparent clarity of the majority's technical holding, Judge Johnson's opinion failed to alleviate the persistent ambiguities surrounding the notice provision and neglected to articulate its justification for elevating the concerns of irresponsible policy holders over those of the insurance industry.

Great American Insurance Company issued an automobile liability policy to Nathan Freeman on February 5, 1981, for a term of six months.[6] Having received $30 of the $53.77 premium due from Freeman on August 27, Great American allegedly renewed the policy for an additional six-month period.[7] On October 14, 1981, the company mailed an "Automobile Final Notice" to Freeman requesting payment of the balance due and warning him that it would cancel his policy on November 1 should he fail to comply.[8] Although Freeman tendered the balance on November 5, 1981, Great American sent him an "Automobile Cancellation Notice" on the same day, stating that it had canceled his policy as of November 1 and that his check would be returned.[9]

Freeman was involved in an automobile accident on November 8, 1981, for

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1. Act of June 12, 1957, ch. 1393, §§ 1-3, 1957 N.C. Sess. Laws 1586 (codified at N.C. GEN. STAT. §§ 20-309 to -319 (1983)).

2. 7 AM. JUR. 2D *Automobile Insurance* § 35 (1980).

3. *See* N.C. GEN. STAT. § 20-310 (1983).

4. *See infra* notes 40-78 and accompanying text.

5. 78 N.C. App. 774, 338 S.E.2d 570, *aff'd per curiam*, 317 N.C. 145, 343 S.E.2d 539 (1986).

6. *Id.* at 775, 338 S.E.2d at 570.

7. *Id.* at 775, 338 S.E.2d at 570-71.

8. *Id.* at 775, 338 S.E.2d at 571. The document also advised Freeman of the following information: his right to request a review by or a hearing before the Commissioner of Insurance, his duty to obtain replacement insurance, and the penalties for driving without maintaining continuous financial responsibility. Record at 28, *Peerless* (No. 852DC347); *see* N.C. GEN. STAT. § 20-310(f)(4)-(5) (1983).

9. Record at 29, *Peerless*.

which Great American denied coverage.[10] As insurer for the other driver, Peerless Insurance Company paid the damages under an uninsured motorists policy and sought subrogation[11] from Freeman, who filed a third-party complaint[12] against Great American.[13] At a hearing before the District Court of Beaufort County, North Carolina, Freeman stipulated that Peerless' motion for summary judgment[14] against him should be allowed.[15] The court granted Peerless' motion as well as a motion for summary judgment in favor of Freeman, but denied Great American's motion for summary judgment.[16]

Great American appealed, asserting that the trial court had erred in deciding that Great American's actions were ineffective to terminate Freeman's policy.[17] The applicable notice provisions of the financial responsibility statute prohibit the insurer from canceling or refusing to renew an automobile insurance policy unless the insured "fails to discharge when due any of his obligations in connection with the payment of premium for the policy or any installment thereof . . . ."[18] In such instance the insurer must send the insured notice of termination disclosing the effective date, fifteen days from the date of mailing or delivery.[19] Comparing the forms Great American sent to Freeman with the

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10. *Peerless*, 78 N.C. App. at 774, 338 S.E.2d at 570.

11. "Subrogation is the right of the insurer to be put in the position of the insured in order to pursue recovery from third parties legally responsible to the insured for a loss paid by the insurer." 16 G. COUCH, CYCLOPEDIA OF INSURANCE LAW § 61:1 (2d ed. 1983). "Subrogation . . . is designed to compel discharge of the obligation by the one who in equity should bear the loss." *Id.*

12. "At any time after commencement of the action a defendant, as a third-party plaintiff, may cause a summons and complaint to be served upon a person not a party to the action who is or may be liable to him for all or part of the plaintiff's claim against him." N.C. GEN. STAT. § 1A-1, Rule 14(a) (1983).

13. *Peerless*, 78 N.C. App. at 774, 338 S.E.2d at 570.

14. A summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law." N.C. GEN. STAT. § 1A-1, Rule 56(c) (1983).

15. *Peerless*, 78 N.C. App. at 774, 338 S.E.2d at 570.

16. *Id.* at 775, 338 S.E.2d at 571.

17. *Id.*

18. N.C. GEN. STAT. §§ 20-310(d)(1), (e)(4) (1983). The relevant sections of the statute read as follows:

> (d) No insurer shall cancel a policy of automobile insurance except for the following reasons:
>
> (1) The named insured fails to discharge when due any of his obligations in connection with the payment of premium for the policy or any installment thereof . . . .
>
> . . .
>
> (e) No insurer shall refuse to renew a policy of automobile insurance except for one or more of the following reasons:
>
> . . .
>
> (4) The named insured fails to discharge when due any of his obligations in connection with the payment of premium for the policy or any installment thereof . . . .

*Id.*

19. N.C. GEN. STAT. § 20-310(f)(2) (1983). The following language appears in this section:

> (f) No cancellation or refusal to renew by an insurer of a policy of automobile insurance shall be effective unless the insurer shall have given the policyholder notice at his last known post-office address by certificate of mailing a written notice of the cancellation or refusal to renew. Such notice shall:
>
> . . .
>
> (2) State the date, not less than 60 days after mailing to the insured of notice of

statutory notice requirements, the majority determined that Freeman had accepted the insurer's offer to renew with his partial payment and that his thirty dollars provided coverage through October 14, 1981.[20] Because Freeman was not yet in default when Great American mailed its final notice, the document was fatally premature as a notice of cancellation.[21]

The cancellation notice dated November 5, 1981, was also defective in failing to allow fifteen days prior notice of the effective date of cancellation.[22] As Judge Phillips concluded in his concurring opinion, "G.S. 20-310 authorizes the cancellation of automobile liability policies only for the *existing* causes stated and upon *advance* notice as provided therein; it does not authorize either prospective or retroactive cancellation."[23] Because Great American had not satisfactorily terminated Freeman's policy, it remained in force on the date of the accident and covered the resulting damages.[24]

Great American argued that such an interpretation of statutory provisions would grant the insured an extension of the policy for which the insurer would remain uncompensated.[25] Instead, Great American contended that the general assembly must have contemplated a requirement that notice of cancellation be conditional, thereby granting the insured an opportunity to satisfy any obligations to the insurer within a specified time period.[26] Judge Johnson dismissed the argument stating: "We believe the Legislature was advertent to the possibility of such gaps in the statute."[27]

In his dissent Judge Webb agreed with the majority's recognition of a fifteen-day grace period beyond the contractual terms of the policy; however, he maintained that Great American had fulfilled the statutory requirements.[28] Because Freeman had never provided full consideration for the first six months of the insurance contract, he had been in default since August.[29] If interpreted as a statement that payment was past due, the final notice effectively canceled the policy on November 1, 1981.[30]

Great American appealed to the North Carolina Supreme Court.[31] Although the appellate court's opinion frequently referred to *Smith v. Nation-*

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cancellation or notice of intention not to renew, on which such cancellation or refusal to renew shall become effective, except that such effective date may be 15 days from the date of mailing or delivery when it is being canceled or not renewed for the reasons set forth in subdivision (1) of subsection (d) and in subdivision (4) of subsection (e) of this section . . . .

*Id.*

20. *Peerless*, 78 N.C. App. at 776, 338 S.E.2d at 571.
21. *Id.* at 776-77, 338 S.E.2d at 571-72.
22. *Id.* at 777, 338 S.E.2d at 572.
23. *Id.* at 778, 338 S.E.2d at 572 (Phillips, J., concurring).
24. *Id.* at 777, 338 S.E.2d at 572.
25. Appellant's Brief at 4, *Peerless*.
26. *Id.*
27. *Peerless*, 78 N.C. App. at 777, 338 S.E.2d at 572.
28. *Id.* at 778, 338 S.E.2d at 572 (Webb, J., dissenting).
29. *Id.*
30. *Id.*
31. Peerless Ins. Co. v. Freeman, 317 N.C. 145, 343 S.E.2d 539 (1986) (per curiam).

*wide Mutual Insurance Co.*,[32] which was subsequently reversed on appeal, the supreme court nevertheless upheld the *Peerless* decision.[33] The per curiam opinion stated that the logic of the appellate court's opinion alone supported its interpretation of the notice provisions of the Vehicle Financial Responsibility Act.[34]

Financial responsibility legislation, the practical equivalent of which exists in every state,[35] is an attempt to assure some compensation for victims of traffic accidents by regulating the rights and obligations of both the insured and the insurer.[36] To achieve these goals, the statutes are liberally construed to protect the state's motorists, so that contractual provisions of the policies are subordinate to public policy evidenced by legislation.[37] North Carolina's version establishes a compulsory liability insurance requirement as a prerequisite to valid registration of a motor vehicle with the State.[38] If such insurance coverage lapses for any reason, the insurer must notify the Division of Motor Vehicles, which may revoke the insured's registration.[39]

The insurer's obligations to its insured upon termination of a policy depend on the circumstances resulting in the conclusion of the contractual relationship—that is, whether the termination constitutes a rejection of an offer to renew by the insured or a refusal to renew or cancellation by the insurer. North Carolina case law, however, illustrates that specifically categorizing terminations continues to be a problem. In the 1961 case of *Faizan v. Grain Dealers Mutual Insurance Co.*,[40] distinguished on its facts in *Peerless*,[41] the North Carolina Supreme Court considered the situation in which the insurer advised the insured of the renewal premium due, but the insured failed to respond.[42] According to Justice Moore's opinion, the renewal premium notice, indicating the consequences of non-payment, was an offer which Faizan rejected by silence and by applying for other insurance.[43] Because a rejection by the insured could not be characterized as termination "by an insurer,"[44] the expiration of the policy did

32. 71 N.C. App. 69, 321 S.E.2d 498 (1984), *aff'd on reh'g*, 72 N.C. App. 400, 324 S.E.2d 868, *rev'd*, 315 N.C. 262, 337 S.E.2d 569 (1985). For details of prior and subsequent history of the *Smith* decision, see *infra* text accompanying notes 52-63.

33. *Peerless*, 317 N.C. at 145, 343 S.E.2d at 539.

34. *Id.*

35. 12A G. COUCH, CYCLOPEDIA OF INSURANCE LAW § 45:721 n.7 (2d ed. 1981).

36. *Id.* § 45:723.

37. 7 AM. JUR. 2D *Automobile Insurance* § 29 (1980).

38. N.C. GEN. STAT. § 20-309 (1983). In the alternative an owner may prove financial responsibility by acquiring a financial security bond or deposit or by qualifying as a self-insurer. *Id.* § 20-309(b).

39. *Id.* § 20-309(e).

40. 254 N.C. 47, 118 S.E.2d 303 (1961).

41. 78 N.C. App. at 777, 338 S.E.2d at 572.

42. The insurance company notified Faizan that his policy would expire unless he renewed by payment of premium. After the due date had passed, the company sent a notice of termination to be effective in 15 days. Faizan was later involved in an accident. *Faizan*, 254 N.C. at 48-50, 118 S.E.2d at 303-05.

43. *Id.* at 59, 118 S.E.2d at 311-12.

44. N.C. GEN. STAT. § 20-310(f) (1983).

not trigger the notice requirements of the financial responsibility statute.[45]

Ten years later, despite subsequent statutory amendments involving notice to the Department of Motor Vehicles,[46] the supreme court relied on *Faizan* in the similar case of *Nationwide Mutual Insurance Co. v. Cotten*.[47] Nationwide sent a renewal premium notice containing an express offer to renew by payment. When Cotten failed to respond, Nationwide sent a termination notice, then notified the Department of Motor Vehicles. Cotten later became involved in an accident.[48] Irrespective of the duty to notify the insured, Cotten argued that termination was contingent on the notification of the Department of Motor Vehicles.[49] Construing Cotten's silence with respect to Nationwide's offer to renew, Justice Lake concluded that the amended notice provisions had "no bearing upon the authority of the Faizan case on the question of what constitutes a termination 'by the insured.' "[50] Because the administrative purposes of notifying the department were distinct from the public policy purposes of notifying the insured, failure to notify the department would not obstruct the valid termination of the insurance contract.

With the theory of termination by the insured apparently settled by *Faizan* and *Cotten*, the general assembly enacted a new provision incorporating the distinction as follows:

> (g) Nothing in this section shall apply:
>
> (1) If the insurer has manifested its willingness to renew by issuing or offering to issue a renewal policy, certificate or other evidence of renewal, or has manifested such intention by any other means;
>
> (2) If the named insured has notified in writing the insurer or its agent that he wishes the policy to be canceled or that he does not wish the policy to be renewed . . . .[51]

In an attempt to interpret the amendment in 1984 the North Carolina Court of Appeals analyzed the issue in *Smith v. Nationwide Mutual Insurance Co.*[52] When Smith failed to reply to Nationwide's renewal premium notice, the policy

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45. *Faizan*, 254 N.C. at 59, 118 S.E.2d at 312. Because § 20-310 did not obligate the insurer to take further action, the termination notice was superfluous and, therefore, irrelevant to the holding. *Id.* at 56-57, 118 S.E.2d at 309-10.

46. In 1963 the general assembly deleted the requirement of after the fact notice of termination to the Department of Motor Vehicles in favor of the following language: "No insurance policy . . . may be terminated by cancellation or otherwise by the insurer without having given the North Carolina Motor Vehicles Department notice of such cancellation fifteen (15) days prior to effective date of cancellation." Act of June 18, 1963, ch. 964, § 1, 1963 N.C. Sess. Laws 1221, 1222 (codified as amended at N.C. GEN. STAT. § 20-309(e) (1983)). A later amendment expressly distinguished between termination by the insured and by the insurer stating, "Where the insurance policy is terminated by the insured the insurer shall immediately notify the Department of Motor Vehicles . . . ." Act of April 16, 1965, ch. 272, § 1, 1965 N.C. Sess. Laws 303, 303 (amended by Act of July 15, 1983, ch. 761, § 146, 1983 N.C. Sess. Laws 790, 843).

47. 280 N.C. 20, 185 S.E.2d 182 (1971).

48. *Id.* at 22-23, 185 S.E.2d at 183-84.

49. *Id.* at 29, 185 S.E.2d at 188.

50. *Id.* at 28, 185 S.E.2d at 187.

51. Act of July 21, 1971, ch. 1205, § 4, 1971 N.C. Sess. Laws 1766, 1772 (codified at N.C. GEN. STAT. § 20-310(g) (1983)).

52. 71 N.C. App. 69, 321 S.E.2d 498 (1984), *aff'd on reh'g*, 72 N.C. App. 400, 324 S.E.2d 868, *rev'd*, 315 N.C. 262, 337 S.E.2d 569 (1985).

lapsed and Nationwide later mailed an "Expiration Notice," purporting to allow an additional sixteen days from the date of expiration in which the policy could be reinstated.[53] An accident occurred during the grace period,[54] and Nationwide refused Smith's belated tender of the full premium.[55] In his opinion for the court, Judge Eagles reasoned that the expiration notice failed to provide the requisite warnings and prospective notice period to effectively cancel the policy.[56] In addition, the court held that Smith's attempt to reinstate the policy was inconsistent with the argument that he had rejected Nationwide's offer to renew.[57]

On rehearing the court of appeals determined that the expiration notice was a defective refusal to renew rather than an attempt to cancel.[58] Because the premium notice contained no advice concerning the consequences of non-payment, it was merely a statement of the balance due and did not constitute an offer to renew.[59] According to Judge Eagles, "G.S. 20-310(g) retains its purpose to allow an insurer to avoid the requirements of G.S. 20-310(f) where the insurer has manifested its willingness to renew and the insured unequivocally rejects the renewal . . . ."[60]

The North Carolina Supreme Court reversed the court of appeals decision on the grounds that such a restrictive interpretation of subsection (g) would destroy its purpose of relieving the insurer of responsibility once it has apprised the insured of his or her policy status and the contract has subsequently expired.[61] By providing notice of pending expiration and opportunity to renew, Nationwide clearly communicated an offer and was entitled to rely on Smith's failure to respond as a rejection.[62] Citing both *Faizan* and *Cotten*, Justice Martin concluded that the protection afforded the insured by the notice requirements of the financial responsibility statute was unnecessary when the decision to continue coverage was in the hands of the insured rather than the insurer.[63]

On the other hand, when the insurer has reason to believe the insured might accept a clear offer to renew, the statute mandates strict compliance with its instructions for refusal to renew. The supreme court in *Smith* distinguished *Perkins v. American Mutual Fire Insurance Co.*,[64] in which Perkins financed his premium with a producing agency under the assigned risk plan.[65] Erroneously

53. *Id.* at 72, 321 S.E.2d at 500.
54. *Id.*
55. *Id.* at 75, 321 S.E.2d at 502.
56. *Id.* at 74, 321 S.E.2d at 501.
57. *Id.* at 75, 321 S.E.2d at 502.
58. *Smith*, 72 N.C. App. at 401, 324 S.E.2d at 870.
59. *Id.* at 406-07, 324 S.E.2d at 873.
60. *Id.* at 408, 324 S.E.2d at 873.
61. *Smith*, 315 N.C. at 272, 337 S.E.2d at 575.
62. *Id.* at 268-69, 337 S.E.2d at 573.
63. *Id.* at 272, 337 S.E.2d at 575.
64. 274 N.C. 134, 161 S.E.2d 536 (1968); *see Smith*, 315 N.C. at 271-72, 337 S.E.2d at 575.
65. *Perkins*, 274 N.C. at 136, 161 S.E.2d at 537. The insured dealt with Terry Insurance Agency in procuring his policy, but the North Carolina Assigned Risk Plan assigned his insurance risk to American Mutual Fire Insurance Company, which actually became a party to his insurance contract. *Id.* at 135, 161 S.E.2d at 537. The assigned risk plan is an element of the Motor Vehicle

assuming it was paying in full, the agency forwarded a substantial portion of the premium to the contracting company.[66] Having received notice of the agency's uncertainty as to the amount due, the insurer could not rely on the insufficient acceptance as a rejection.[67] As a unilateral act of the insurance company, the termination of Perkins' policy was ineffective without prospective notice.[68]

Similarly, the court of appeals in *Nationwide Mutual Insurance Co. v. Davis*[69] established that the insurer may not avoid the notice provisions when its alleged offer is vague. The premium notice Nationwide sent to Davis contained neither a reference to expiration of the policy nor any warning of the consequences of non-payment; therefore, it merely presented a statement of the account due.[70] Because renewal is a "bilateral transaction involving both an offer and acceptance," the failure to make an absolute offer prior to expiration resulted in a unilateral refusal to renew on the part of the insurer.[71] Under these circumstances prior notification of termination to the insured was necessary to provide an opportunity to rectify a potential violation of the law.[72]

Once an insurer commits itself to a contract with the insured, mid-term cancellation jeopardizes the insured's driving privileges even more seriously than a refusal to renew. In *Crisp v. State Farm Mutual Automobile Insurance Co.*[73] the company accepted partial payment from the insured and, following a change in coverage, billed him for the balance due.[74] After the due date had passed, State Farm sent the insured a cancellation notice to take effect in fifteen days.[75] Applying the terms of the Vehicle Financial Responsibility Act to State Farm's attempted termination, the supreme court determined that the statute controlled the contract to the extent that even non-payment was no defense to a claim when the appropriate procedure had not been followed.[76] State Farm had neglected to advise the insured of the necessity of maintaining continuous financial responsibility, a requirement Justice Moore found to be "not merely formal and directory."[77] Particularly in a suit by an injured third party, for whom financial responsibility legislation supposedly provides protection, the policy must remain in force absent proof of compliance.[78]

The North Carolina General Assembly derived its version of the statute

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Safety-Responsibility Act, which requires all insurers doing business in North Carolina to accept a certain percentage of high risk applicants for automobile liability insurance in order to make insurance readily available to all drivers. *See* N.C. GEN. STAT. § 20-279.34 (1983).

66. *Perkins*, 274 N.C. at 136, 161 S.E.2d at 537.
67. *Id.* at 143, 161 S.E.2d at 542.
68. *Id.* at 142-43, 161 S.E.2d at 542.
69. 7 N.C. App. 152, 171 S.E.2d 601 (1970).
70. *Id.* at 159-60, 171 S.E.2d at 605.
71. *Id.* at 158, 171 S.E.2d at 604.
72. *See Perkins*, 274 N.C. at 140, 161 S.E.2d at 540.
73. 256 N.C. 408, 124 S.E.2d 149 (1962).
74. *Id.* at 410-11, 124 S.E.2d at 151.
75. *Id.* at 411, 124 S.E.2d at 151-52.
76. *Id.* at 413, 124 S.E.2d at 153.
77. *Id.* at 414, 124 S.E.2d at 154.
78. *Id.*

from New York legislation,[79] the construction of which has proven equally ambiguous. The 1959 case of *Teeter v. Allstate Insurance Co.*[80] presented the New York judiciary with an opportunity to construe the Motor Vehicle Financial Security Act of 1956.[81] Although Allstate had reason to rescind Teeter's policy for misrepresentation of his accident record, the court refused to allow retroactive cancellation to void the policy from inception.[82] With respect to the notice of cancellation requirements, the court concluded,

> Once a certificate of insurance . . . has been issued by the insurance company and filed with the Commissioner, the contract of insurance ceases to be a private contract between the parties. A supervening public interest then attaches and restricts the rights of the parties in accordance with the statutory provisions. Many common-law contractual rights are restricted by the statute.[83]

In *Connecticut Fire Insurance Co. v. Williams*[84] the Appellate Division of the New York Supreme Court considered the contractual prerequisites of offer and acceptance regarding renewal. The insurer failed to locate the insured and, therefore, tendered no offer to renew.[85] Although the insured's default on previous occasions gave the insurer adequate reason to refuse to renew, the attempted termination technically resulted from a unilateral act of the insurer, which was ineffective without prior notice.[86] In the subsequent case of *Caristi v. Home Indemnity Co.*,[87] the company also failed to provide a written offer of renewal to the insured; however, the court distinguished *Williams* because the company presented evidence that Caristi expressly rejected an oral offer.[88]

Unlike North Carolina decisions, New York courts did not develop an exception to the notice provisions of the financial responsibility statute when the insured's silence constituted a rejection of an offer to renew resulting in termination.[89] Three 1962 cases, each dealing with the insured's lack of response to a

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79. *See Perkins*, 274 N.C. at 140-42, 161 S.E.2d at 540-41; *Faizan*, 254 N.C. at 57-59, 118 S.E.2d at 310-11. The 1956 New York statute read as follows:

> No contract of insurance or renewal thereof for which a certificate of insurance has been filed with the commissioner shall be terminated by cancellation or failure to renew by the insurer until at least twenty days after mailing to the named insured at the address shown on the policy a notice of termination, except where the cancellation is for non-payment of premium in which case ten days notice of cancellation by the insurer shall be sufficient.

N.Y. VEH. & TRAF. LAW § 93-c (McKinney Supp. 1959).

80. 9 A.D.2d 176, 192 N.Y.S.2d 610 (1959), *aff'd*, 9 N.Y.2d 655, 173 N.E.2d 47, 212 N.Y.S.2d 71 (1961).

81. Motor Vehicle Financial Security Act, ch. 655, 1956 N.Y. Laws 1457 (amended by Act of April 23, 1959, ch. 775, 1959 N.Y. Laws 1855) (codified as amended at N.Y. VEH. & TRAF. LAW §§ 310-321 (McKinney 1986)).

82. *Teeter*, 9 A.D.2d at 180, 192 N.Y.S.2d at 614-15.

83. *Id.* at 181, 192 N.Y.S.2d at 616.

84. 9 A.D.2d 461, 194 N.Y.S.2d 952 (1959).

85. *Id.* at 462, 194 N.Y.S.2d at 953.

86. *Id.* at 463, 194 N.Y.S.2d at 954.

87. 24 Misc. 2d 136, 202 N.Y.S.2d 340 (1960).

88. *Id.* at 137, 202 N.Y.S.2d at 341.

89. *Cf. supra* notes 40-63 and accompanying text (discussing North Carolina cases establishing the theory of termination by the insured).

renewal premium notice, resulted in extended coverage for the insured because the insurer disregarded the notice provisions of the statute.[90] In the words of Justice Gorman in *Monette v. Nationwide Mutual Insurance Co.*,[91] "an automobile policy under the assigned risk plan cannot be terminated by the insured's failure to accept the insurer's conditional offer to renew upon payment of the premium."[92]

The difficulties of distributing responsibility for termination of an automobile liability policy, thereby determining the obligations of the insurer with respect to notice, are common among states with compulsory liability insurance laws.[93] Few courts, however, have approached the subject of the time limitations on the notice requirements with the specificity indicated in *Peerless*. In states where the statutes are substantially similar to that of North Carolina—for instance, Illinois and Connecticut[94]—retroactive notice is clearly contrary to legislative intent. When the insurer in *Green v. J.C. Penney Auto Insurance Co.*[95] discovered that the insured's premium renewal check had been dishonored, it attempted to cancel his policy as of the date of reinstatement.[96] Decisively rejecting the company's defense of its action, the United States Court of Appeals for the Seventh Circuit concluded that insurers would deprive the insured of the opportunity to obtain other insurance as required by the Illinois statute,[97] unless the law prescribed notice prior to effective cancellation in all instances of default.[98]

Similarly, in *Travelers Insurance Co. v. Hendrickson*[99] the insurer accepted half the renewal premium due and credited it to Hendrickson's account, but subsequently notified him in an offer to reinstate that the original policy had expired.[100] The Connecticut Appellate Court determined that the company misled the insured by crediting his account as if coverage had never lapsed.[101] Under these circumstances the financial responsibility statute prevented the company from asserting expiration retroactively by requiring ten days notice prior to cancellation for non-payment of premium.[102]

On the other hand, at least one state has established that the grace period prohibits the insurer from anticipating default in payment of premiums. In

90. *See* Monette v. Nationwide Mut. Ins. Co., 230 N.Y.S.2d 939 (1962); La Barre v. Nationwide Mut. Ins. Co., 16 A.D.2d 842, 227 N.Y.S.2d 632 (1962); Mong v. Allstate Ins. Co., 15 A.D.2d 257, 223 N.Y.S.2d 218 (1962).

91. 230 N.Y.S.2d 939 (1962).

92. *Id.* at 942.

93. *See* Annotation, *Cancellation of Compulsory or "Financial Responsibility" Automobile Insurance*, 44 A.L.R. 4TH 13 (1986).

94. *See* CONN. GEN. STAT. § 38-175h (Supp. 1987); ILL. ANN. STAT. ch. 73, ¶ 755.15 (Smith-Hurd Supp. 1986).

95. 722 F.2d 330 (7th Cir. 1983).

96. *Id.* at 331.

97. *Id.* at 332.

98. *Id.* at 333.

99. 1 Conn. App. 409, 472 A.2d 356 (1984).

100. *Id.* at 410-11, 472 A.2d at 357.

101. *Id.* at 411-12, 472 A.2d at 358.

102. *Id.* at 412-13, 472 A.2d at 359.

*Pennsylvania National Mutual Casualty Insurance Co. v. Person*[103] the Georgia Court of Appeals found that the insurer's incorporation of notice of the premium due and of prospective cancellation was unsatisfactory under state law.[104] As in North Carolina, Georgia's insurance statutes permitted the insurer to cancel for failure to discharge premium obligations "when due."[105] In the appellate court's estimation the company had no reason to give notice of cancellation before the premium was due and could conclusively terminate the policy only after a ten-day grace period following default.[106]

The practice of accepting partial payments introduces an additional complication to the grace period equation. According to the Missouri Court of Appeals in *McGarrah v. Stockton*,[107] the consideration for an insurance contract is indivisible even if paid in installments.[108] In *McGarrah* the Missouri appellate court relied on the 1915 case of *Clifton v. Mutual Life Insurance Co.*,[109] in which the North Carolina Supreme Court held: "Partial payment, even when accepted as a partial payment, will not keep the policy alive even for such fractional part of the year as the part payment bears to the whole payment."[110] Consequently, the insured in *McGarrah* was in default from the inception of the policy so that the insurer's notice of the balance due and subsequent cancellation were neither retroactive nor prospective.[111]

In reaching its conclusion that the insurance company's prospective final notice and retroactive cancellation notice were both defective, the North Carolina Court of Appeals in *Peerless* ignored most of the available authority on the issue and misconstrued the landmark *Faizan* case as well as the recent *Smith* decision. Although Judge Johnson distinguished *Faizan* on its facts, he relied on its discussion of legislative intent regarding notice requirements.[112] Upon careful inspection, however, the section of the *Faizan* decision to which Judge Johnson referred elaborated on the procedure for notification of the Commissioner of Insurance after termination, rather than notification of the insured before termination.[113] Moreover, Justice Moore in *Faizan* wrote in terms of "an *hiatus* of

103. 164 Ga. App. 488, 297 S.E.2d 80 (1982).

104. *Id.* at 489, 297 S.E.2d at 82.

105. GA. CODE ANN. § 56-2430(e) (Supp. 1982).

106. *Person*, 164 Ga. App. at 489, 297 S.E.2d at 82.

107. 425 S.W.2d 223 (Mo. Ct. App. 1968).

108. *Id.* at 227.

109. 168 N.C. 499, 84 S.E. 817 (1915). The *Clifton* case involved a suit on a life insurance policy after a default in installment payments. *Id.*

110. *Id.* at 500, 84 S.E. at 818; *see also* Klein v. Avemco Ins. Co., 289 N.C. 63, 66, 220 S.E.2d 595, 597 (1975) (quoting *Clifton* for the proposition that installments previously paid for airplane insurance may not be pro-rated). The foremost treatise in the area of insurance law includes the following similar language also quoted in *McGarrah*:

> The obligation to pay the premium when due is ordinarily an indivisible obligation to pay the entire premium, so that a forfeiture is not prevented by part payment thereof. This means that a part payment will not keep the policy in force for even such a proportionate part of the new period as the sum paid bears to the whole premium due.

6 G. COUCH, CYCLOPEDIA OF INSURANCE LAW § 32:111 (2d ed. 1985).

111. *McGarrah*, 425 S.W.2d at 227.

112. *Peerless*, 78 N.C. App. at 777, 338 S.E.2d at 572.

113. *Faizan*, 254 N.C. at 55, 118 S.E.2d at 309.

fifteen days or more in insurance coverage,"[114] not an extension of policy coverage. Because the prescribed subsequent notice to the Commissioner posed no obstacle to an effective termination fifteen days earlier, the *Faizan* court was concerned with the gaps between coverage,[115] during which the former policy holder could continue to drive uninsured.

Although the North Carolina Supreme Court concluded that the citation in *Peerless* to the subsequently reversed *Smith* case was not determinative in the final analysis,[116] the appellate court's opinion presented the statements regarding statutory construction out of context, again illustrating the weakness of its rationale. Judge Johnson relied on the decision on rehearing in *Smith* for the proposition that the statute contemplated an extension of insurance coverage because any other construction "would render the protection offered to the motoring public by these statutes meaningless."[117] Such an interpretation is misleading because the *Smith* opinion applied this language to refute an unrelated argument that the insurer's offer to renew has legal effect independently of its acceptance or rejection by the insured.[118] In relying on the *Faizan* and *Smith* decisions to dismiss the defendant insurance company's objections to an uncompensated extension of Freeman's policy coverage, the *Peerless* majority contributed to the confusion surrounding methods of termination and the requisite notice procedures and left the insurer's valid point unanswered.

Obviously, the general assembly had the authority to alter common law contractual rights by statute;[119] therefore, the essential question in *Peerless* was whether the members intended to do so with respect to the timeliness of the notice requirements in particular. Great American Insurance Company, the third-party defendant, contended that the postponement of effective cancellation would unreasonably amend the insurance contract to provide fifteen days of coverage for which it would not be entitled to collect premiums.[120] Furthermore, policy holders could abuse such an extension, avoiding payment indefinitely by writing bad checks or making frequent minor changes in the policy.[121]

The majority position adopted in *Peerless* concerning extension of coverage assumes that insurers may not logically issue a notice of cancellation for nonpayment of premiums until the insured is actually in default.[122] The purpose of

114. *Id.* (emphasis added).

115. *Id.*

116. *Peerless*, 317 N.C. at 145, 343 S.E.2d at 539.

117. *Peerless*, 78 N.C. App. at 777, 338 S.E.2d at 572.

118. Smith v. Nationwide Mut. Ins. Co., 72 N.C. App. 400, 405, 324 S.E.2d 868, 872, *rev'd*, 315 N.C. 262, 337 S.E.2d 569 (1985).

119. *See Teeter*, 9 A.D.2d at 181, 192 N.Y.S.2d at 616; 7 AM. JUR. 2D *Automobile Insurance* § 36 (1980); 12A G. COUCH, *supra* note 35, § 45:722.

120. Appellant's Brief at 4, *Peerless*.

121. *See, e.g.*, Green v. J.C. Penney Auto Ins. Co., 722 F.2d 330 (7th Cir. 1983) (after the check was dishonored upon a second presentment the policy holder had held insurance for two months without providing consideration); Crisp v. State Farm Mut. Auto. Ins. Co., 256 N.C. 408, 124 S.E.2d 149 (1962) (by changing the coverage two months after inception the policy holder had held insurance for more than four months without making full payment).

122. *Accord* Pennsylvania Nat'l Mut. Casualty Ins. Co. v. Person, 164 Ga. App. 488, 489, 297 S.E.2d 80, 82 (1982).

the notice provisions is to provide the insured with an opportunity to acquire substitute insurance and to rectify a potential violation of the law.[123] If this purpose is accomplished by notice referring to the expiration date and warning of the consequences of failure to pay,[124] prospective notice fulfills these goals as well as extended notice. Although the implications eluded the court in *Peerless*, perhaps the answer lies in the *Faizan* discussion of legislative intent: a grace period beyond the terms of the contract eliminates the gap between termination of insurance and notice of termination to government officials who may then take preventive action.[125] Because the predominant goal of financial responsibility legislation is to create a resource for compensation for potential accident victims,[126] the general assembly is justified in modifying the terms of the insurance contract to assure that the State has adequate opportunity to revoke the registration of a formerly insured driver.

In applying its conclusions, the *Peerless* majority disregarded the weight of authority rejecting the possibility of providing coverage proportionate to partial payment.[127] In spite of its brevity and lack of reference to available precedent, Judge Webb's dissenting opinion advocated the most acceptable result under the circumstances.[128] By retaining Freeman's thirty dollars, Great American gave him reason to believe he had insurance and, therefore, the court could have estopped the company from denying the existence of a contract.[129] However, Freeman failed to discharge his obligation of consideration "when due" upon renewal of the policy. Although the final notice designated a division of the payment period,[130] the contention that the company pro-rated insurance coverage through October 14, 1981, so that it could not demand payment and give notice of conditional cancellation on that date, is unsupportable.[131]

By accepting partial payment for an automobile liability insurance renewal contract, Great American unnecessarily subjected itself to the demands of the Vehicle Financial Responsibility Act. The purpose of financial responsibility legislation is not to force insurers to provide free coverage for undesirable customers, but to protect their potential accident victims who would otherwise face the same difficulties the insurer faces when attempting to hold an insured financially responsible. Public policy dictates that insurers must agree to accept some percentage of high-risk clients but, if proper procedure is followed, the insurer is

123. *See Green*, 722 F.2d at 332.

124. *See* Nationwide Mut. Ins. Co. v. Davis, 7 N.C. App. 152, 159, 171 S.E.2d 601, 605 (1970).

125. *See Faizan*, 254 N.C. at 55, 118 S.E.2d at 308-09.

126. *See supra* notes 36-39 and accompanying text.

127. *See, e.g.*, Travelers Ins. Co. v. Hendrickson, 1 Conn. App. 409, 472 A.2d 356 (1984); McGarrah v. Stockton, 425 S.W.2d 223 (Mo. Ct. App. 1968); Perkins v. American Mut. Fire Ins. Co., 274 N.C. 134, 161 S.E.2d 536 (1968); Crisp v. State Farm Mut. Auto. Ins. Co., 256 N.C. 408, 124 S.E.2d 149 (1962) (all of which construe partial payment as effective acceptance of an offer to insure or renew but also as grounds for cancellation by appropriate measures).

128. *See supra* text accompanying notes 28-30.

129. *See Hendrickson*, 1 Conn. App. at 411-12, 472 A.2d at 358.

130. Record at 34, *Peerless*. At the upper right hand corner of the final notice, the account statement showed that no payments had been received and that $25.77 was due under the "2 Pay Option." *Id.* Neither party submitted other evidence of a credit arrangement.

131. *See supra* notes 109-11 and accompanying text.

in no way prevented from terminating a contractual relationship when the contract is breached. Consequently, in spite of the questionable rationale of its opinion, the majority of the North Carolina Court of Appeals in *Peerless* correctly subordinated the interests of insurers to those of innocent motorists in holding the insurer to the terms of the contract. In this case, however, Freeman's failure to discharge his obligation of consideration entitled Great American to take advantage of the opportunity to escape responsibility, which it accomplished by providing the requisite notice of cancellation.

JENNIFER ANN WEST